

UBS Investment Research

UBS Global I/O™: Potash

Compact supply + staunch demand = profit

■ **87% of available capacity in the hands of 6 trading groups**

Very consolidated supply and a history of effective mitigation of price correction lowers downside risk on this commodity

■ **Chinese negotiation settlement delays drive expectations**

Settlement expected after Chinese New Year. We anticipate an increase of \$130-\$180 per ton. This not only impacts earnings outlooks but sets the benchmark for subsequent negotiations

■ **A long term Potash price above \$500/ton is realistic**

Capacity addition threshold is US\$300-US\$400 a ton, but we believe the true cost is higher due to mineral availability and accessibility to industry expertise

■ **Upside for Uralkali, Potash Corp, Israel Chem, Agrium, Salt-Lake**

Uralkali and Salt Lake are Potash pure plays but Israel Chemicals, Agrium and Potash Corp have Potash as a core earnings driver. In a separate note, we upgrade our price target for Uralkali.

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Long term price elevation likely

Table 1: Potash supply, demand and pricing forecasts

	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E
Capacity '000 tons	37,205	38,007	38,682	39,585	40,098	40,754	42,106	43,819	45,144
Change in capacity	0.8%	2.2%	1.8%	2.3%	1.3%	1.6%	3.3%	4.1%	3.0%
Production '000 tons	28,617	31,431	33,376	30,381	33,760	35,708	37,255	38,398	39,501
Change in production	6.2%	9.8%	6.2%	-9.0%	11.1%	5.8%	4.3%	3.1%	2.9%
Capacity Utilisation %	77%	83%	86%	77%	84%	88%	88%	88%	88%
Potash (std) Vancouver fob US\$/ton bulk	118	137	161	175	210	375	450	500	500

Source: Fertecon, UBS Estimates; Note FOB – means “free on board” at the dispatch port

Pricing and market dynamics

Table 2: Standard Potash regional price forecasts, US\$ bulk

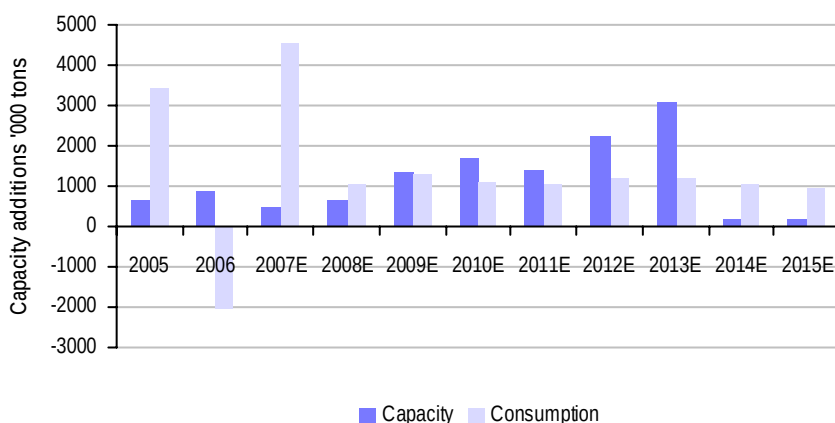
	2007E	2008E	2009E	2010E	2011E
Vancouver FOB	210	375	450	500	500
FSU Baltic FOB	210	375	450	500	500
India CFR	270	425	500	550	550
SE Asia CFR	330	525	575	645	640
Brazil CFR	270	390	452	495	492

Source: Fertecon, UBS Estimates; Note CFR is the fully delivered cost to the specific location

Potash demand remains extremely strong with a highly consolidated supply environment. Significant changes in supply demand do not occur until after 2010.

Supply demand is extremely tight with operating rates of 88% being close to maximum for these types of assets

Chart 1: Changes in supply/demand

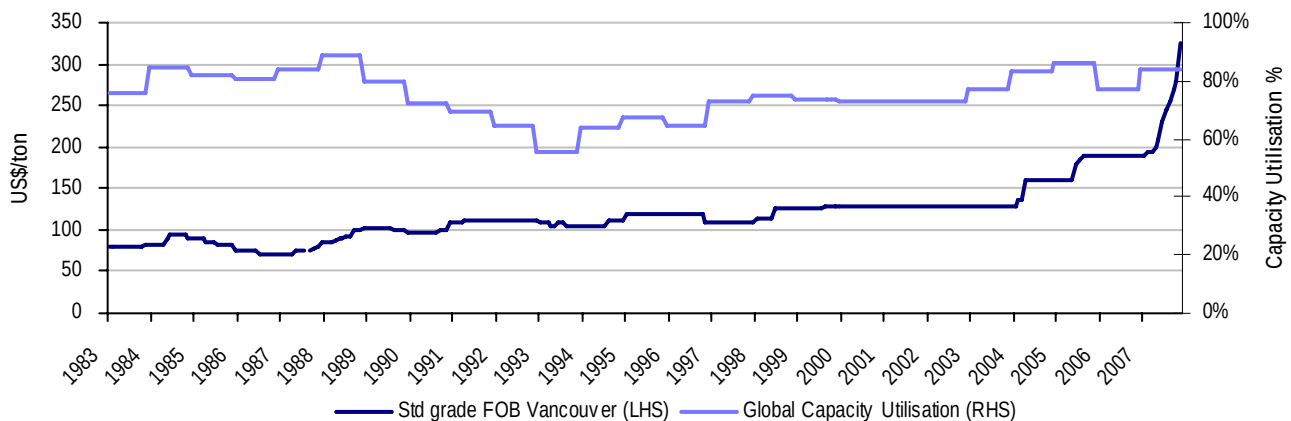


Source: Fertecon, UBS Research

Sales from 87% of available capacity are controlled by six trading organisations. Canpotex and BPC (Belarusian Potash Company) control 57% and historically the consolidated supply environment has enabled a stable price regime in spite of utilisation fluctuations

Consolidated supply mitigates price downside risks

Chart 2: Spot price and global utilisation history



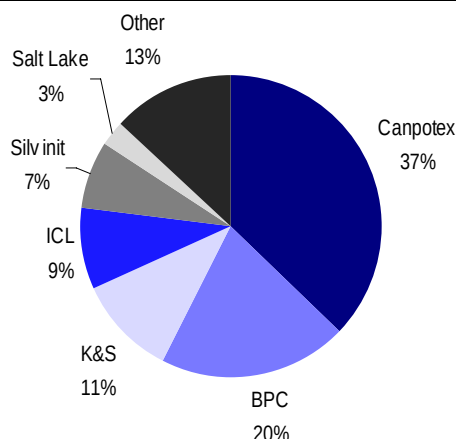
Source: Fertecon

We now estimate that long term pricing for potash is above US\$500 a ton FOB. While we estimate the threshold for new capacity addition to be between \$300-\$400/ton we believe that this does not fully capture the real cost of capacity expansion. Accessibility to mineral resources, logistics and expertise raise the real hurdle costs above a pure cost of capital thesis. Longer term pricing of other commodities also reflect that hurdle costs are far higher than pure investment capital alone

Long term potash price above \$500/ton is a reality

Supply

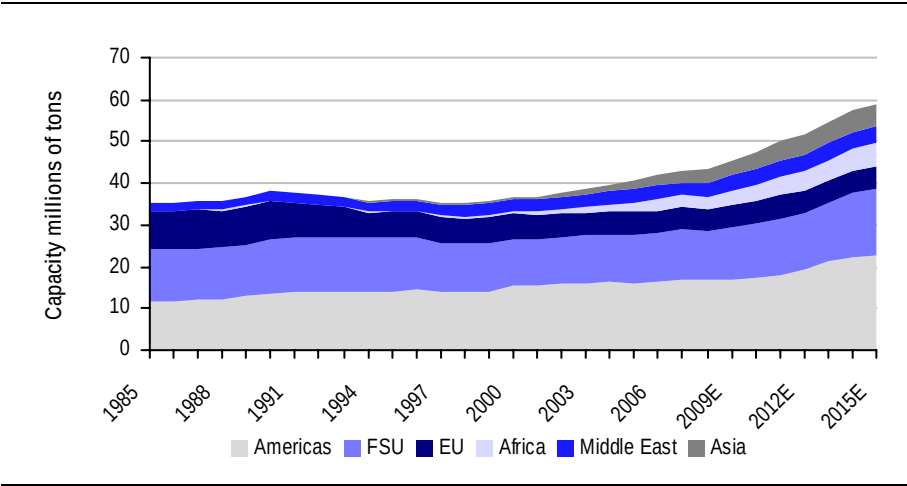
Supply is highly consolidated with six organisations responsible for 87% of traded capacity. Canpotex and BPC are responsible for 57% alone. We believe that if weather events significantly impacting demand, supply has the capability to adjust and hence reduce price downside risk. Pricing history versus capacity utilisation in chart 2 above reflects this.

Chart 3: Global Potash Capacity by trade 2007 (% of 40.0m tons K₂O basis)

Source: Fertecon, UBS Research;

North America and the FSU will offer most capacity growth

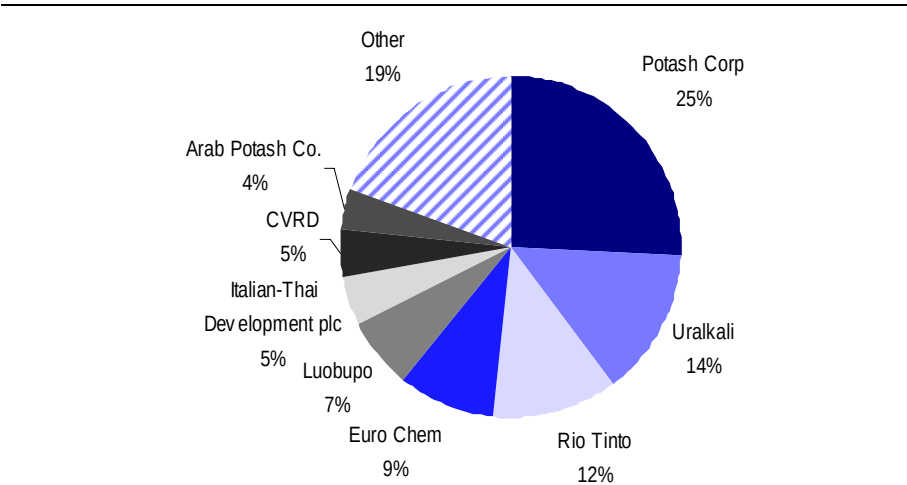
Chart 4: Potash supply capacity (K₂O basis)



Source: Fertecon, UBS Research

40% of capacity to be added will be with Canpotex and BPC partners and hence we see limited dilution of their strong trading position moving forward

Chart 5: Capacity addition from 2008 – 2015 by operator, % of 14m tons



Source: Fertecon, UBS Estimates

Incumbents are prominent in the addition of new capacity and this will maintain the status quo

Demand

The spectre of Chinese contract price negotiations will continue to hold the bulk of market focus until settled. There are two important elements, obvious earnings clarity on product traded with China, but also a clear benchmark for future large negotiations. We believe that the settled price will be between \$130-\$180/ton. It is a supplier's market and China has no palatable alternative to ensuring the supply of potassium nutrient to the farmer.

Crop fundamentals remain strong and we conclude that global acreage levels will be at record levels in the 07/08 and 08/09 growing seasons.

Crop margins are at record levels which we believe will further stimulate the growth engines of Asia, Latin America and the FSU (Countries of the former Soviet Union) to turn to greater levels of farming sophistication.

Biofuel demand has been stimulant in recent years for demand growth but traditional drivers of growing population and improved nutrition will continue to be the mainstay.

What do these Chinese negotiations really mean?

It's a sellers market and BPC, who are currently spearheading negotiations, have the stronger position. China's demand requirements are not substitutable, while global production operating rates are at a maximum. We expect to see a 2008 Chinese contract price agreement of \$130-\$180 per ton after Chinese New Year which equates to \$310 – 360 per ton FOB net back.

For producing companies this means 08 earnings from Chinese exports would increase by 70-100% - hence some significant upside on 07 earnings.

For traders the Chinese contract agreement clears the path for subsequent agreements with other significant markets of Europe, US, Brazil and South East Asia

Chinese consumption of potash fertiliser is estimated to be 22% of global consumption in 2007 and we estimate its CAGR for 08-15 is 3%. China has some local production but relies on imports for more than 70% of its supply. Since there is no substitute for potash it is unavoidably dependent on imports.

Our view is that the negotiating power is heavily weighted towards the suppliers. The Chinese government is very concerned about food inflation taking hold and causing labour instability. They are very driven towards ensuring local crop yields are as high as possible to minimise reliance on imports for food. Any disruption to fertiliser supply prior to and during the soybean season (April – October) will be something they likely want to avoid at all costs.

While China does have some potash inventories of what Fertecon estimates to be about 3.5 million tons, it is important to take note of why these inventories exist in the first place. The government has capped prices of NPK fertiliser which are a blend of potash, nitrogen and phosphate fertilisers. The capped prices and rising input costs have narrowed margins to such an extent that production of NPK's have slowed in China. Hence the build up in Potash is at the expense of NPK inventories, and if farmers cannot access required potassium nutrients from NPK fertilisers they will add potash instead. What we

All eyes are on Chinese negotiations and we expect a \$130-\$180/ton increase over the 2007 settled figure

Sellers have the power and China has no option but to secure supply of potash

China is significant accounting for 22% of global consumption of potash

Chinese government concerns on food price inflation increases the urgency to secure supply

Inventories on a potassium basis are not extraordinary

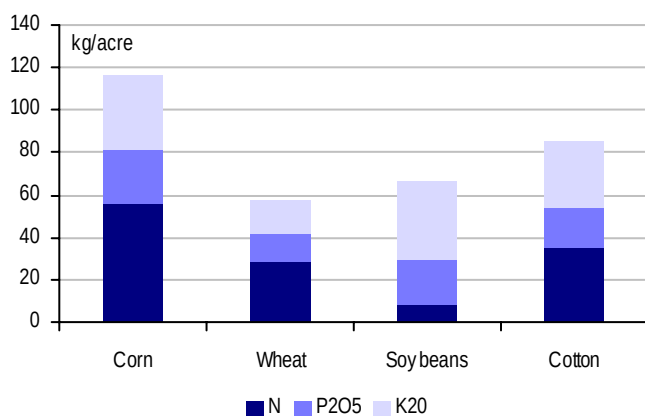
have is no real change in overall “K – Potassium” inventories in the supply chain.

China negotiates contract prices run on a calendar year basis and are settled on an FOB basis. Though never published, the 2007 contract price was estimated by Fertecon to be US\$179 per ton FOB Vancouver. To illustrate the gap between the previous agreed contract price and the status quo we will consider some recent price settlements. This week a SE Asian customer agreed contract prices for Q2/08 at US\$ 525 per ton CFR, which on an FOB net back basis is about \$425-450 per ton. Baltic spot FOB prices were \$300-400 a ton as at 29th January 2008. We believe that there will be some volume discount to prevailing prices and hence are expecting an agreed Chinese contract price of \$310 – 360 per ton.

Crop acreage and demand - likely to another bumper year

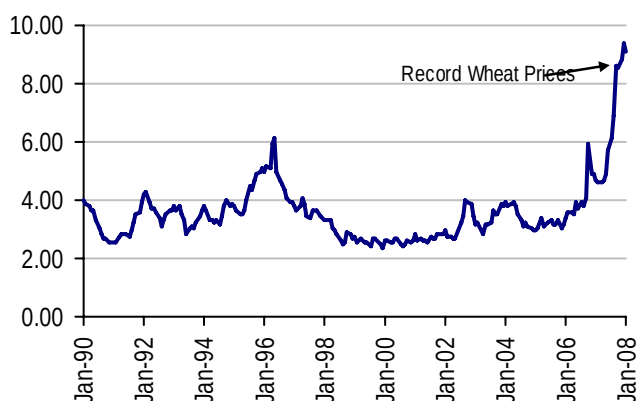
Crop fundamentals are strong

Chart 6: Fertiliser application rates by major crop



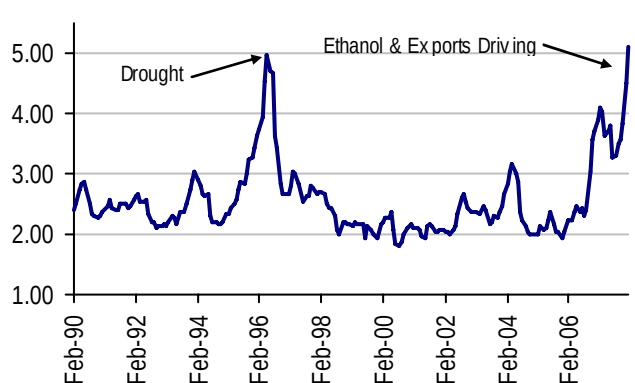
Source: Potash Corp

Chart 8: Wheat Prices (\$/bu.) – 1990-present



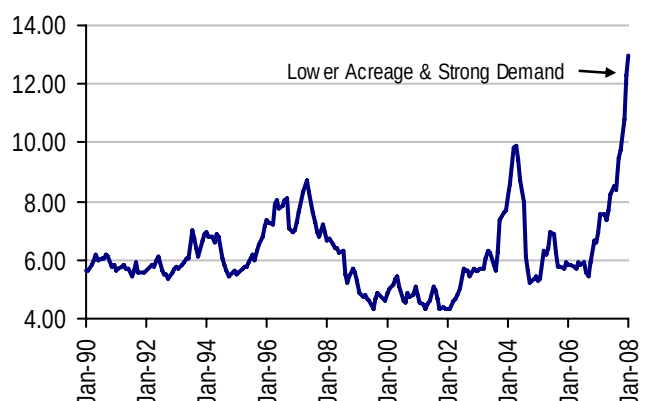
Source: StockVal

Chart 7: US spot corn prices



Source: StockVal

Chart 9: Soybean Prices (\$/bu.) – 1990-present



Source: StockVal

Our commodity analysts have a bullish outlook for soybeans in particular with prices per bushel in the 07/08 season to be more than double their levels in the 06/07 season. US ending inventories are forecast at just 21 days of supply for the end of August. Combined with anticipated increased imports from China (c40% global imports in 2007) the market will need significant increased US planted acreage this spring combined with strong South American harvests. Neither currently look like being sufficient to make up the shortfall

We forecast high crop prices for 07/08

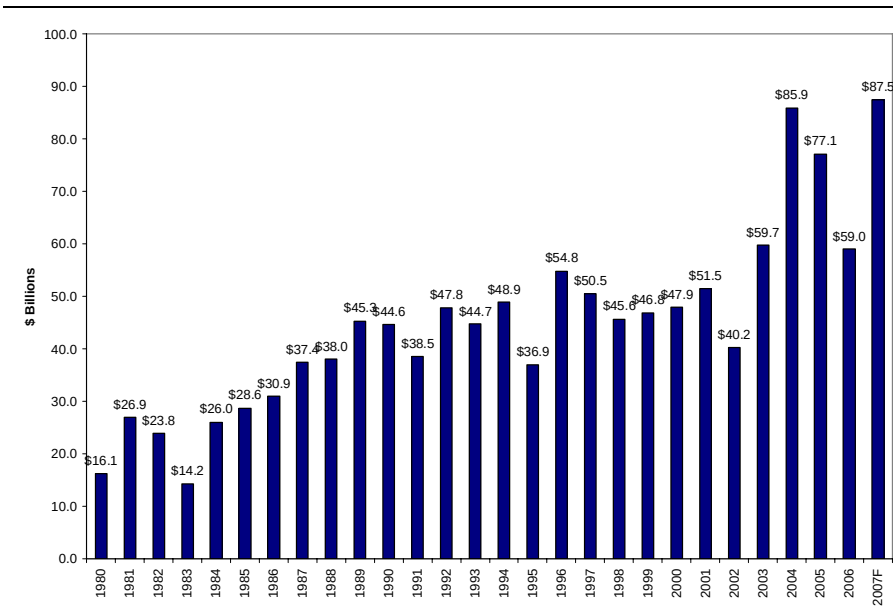
Wheat futures markets have again hit fresh nominal highs following more negative harvest news flow (Argentina and Canada), a weakening US dollar and increased global concern over very low stock levels. We remain positive on wheat fundamentals given continued severe vulnerability to weather disruptions.

Rising farm incomes are changing farming practices

Crop margins serve to stimulate farmers to become increasingly focussed on yields particularly in emerging markets where available technology is not fully employed.

Higher crop margins will continue to stimulate farming technology take up in emerging economies

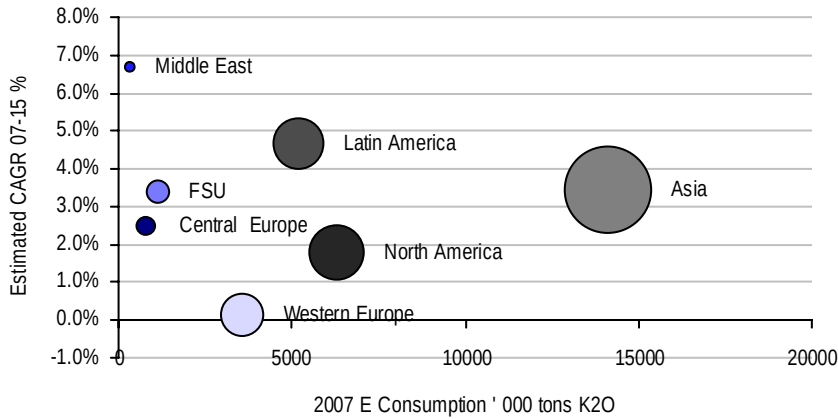
Chart 10: US net farm income , 1980 - present



Source: USDA

The emerging economies will be the growth engines and have the greatest potential for greater usage of agrichemical technology

Chart 11: Potash regional growth 08-15 forecasts versus today's market size

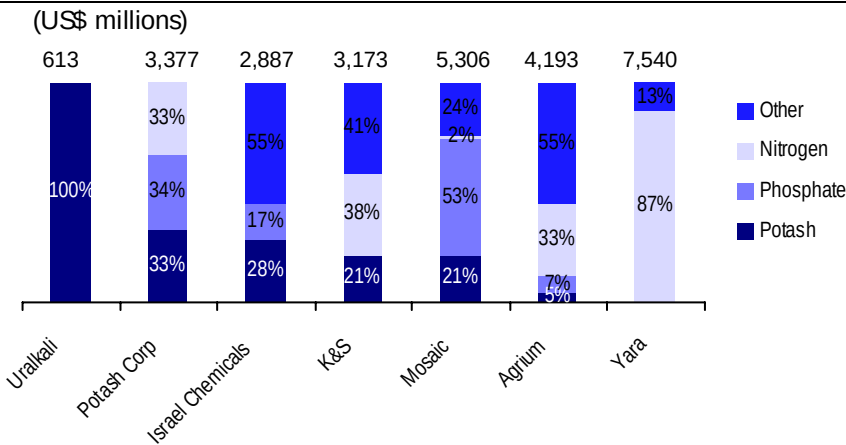


Source: Fertecon, UBS. Bubble size is proportional to 2007 consumption estimates

Equity impacts

Uralkali and Salt Lake Potash are the only pure-play potash producers under coverage.

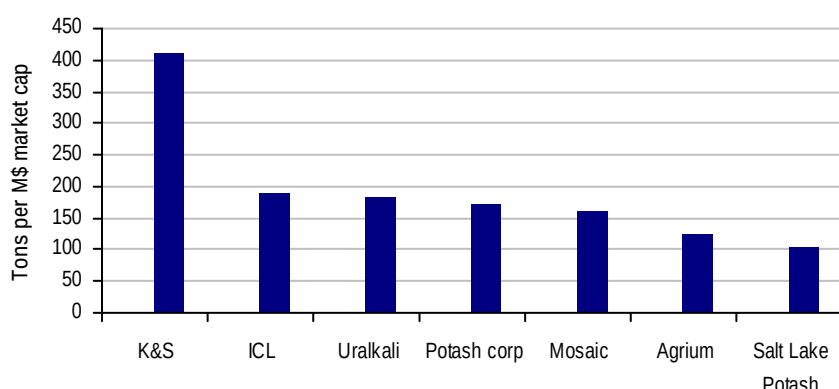
Chart 12: Company sales split by nutrient (2006 basis)



Source: UBS, company reports

On a tonnage per \$ of market cap K&S and Salt Lake Potash are the key outliers

Chart 13: Potash 2007 K2O capacity per \$m of market Cap



Source: Fertecon, UBS Estimates

Uralkali (Buy)

Uralkali is one of the leading potash producers in the world with 2007 output of 5.1 million tons. Exploiting one of the largest potash deposits in Russia's Urals region, Uralkali focuses on potash business only, with good growth prospects, low production costs, and one of the biggest reserves globally. By 2010E, it plans to increase product capacity to 7.0 million tons at its two operational mines, while the Mine 5 project should add significant (3-4 million tons) capacity in the longer-term. Around 90% of Uralkali's sales are for exports, most of which are conducted through BPC (trading entity organized together with Belaruskali) to major consumers in China, India and Brazil. BPC is one of only two organizations globally, the other one being Canpotex, which together control over 57% of the global export potash trade. Uralkali also owns a bulk terminal in the Baltics through which all its seaborne exports are shipped.

As a results of the upgrade to our potash price assumptions, we increase our price target for Uralkali to \$9/share (\$45/GDR), while maintaining Buy rating. See our note on Uralkali, also dated today, for further information.

Agrium (Buy)

Agrium is a major North American fertilizer producer with numerous nitrogen plants, two phosphate plants and one potash mine and a large retail business.

While it is the largest North American nitrogen producer in Potash it has one low cost mine in Canada that can be expanded. In phosphate Agrium has a profitable niche business in the Western part of North America, thus we believe Agrium should benefit from higher Potash and Phosphate prices and its largest leverage is in nitrogen.

Potash Corp (Buy)

Potash Corp is one of the world's largest and lowest-cost publicly traded potash producers and is also the world's third-largest phosphate producer. Thus the company is better known for its exposure to potash and phosphate two commodities which UBS also has a very positive outlook.

Its potash reserves are sufficient for over 100 years of production. The company controls over 50% of the World's excess potash capacity and has always followed a price leadership strategy where it has matched production to sales. Thus we believe it is well positioned to benefit from higher potash prices.

Potash Corp. is also one of the World's largest phosphate producers and has a very good phosphate rock position with reserves that should last more than 50 years. Its North Carolina plant is one of the world's lowest cost producers of phosphoric acid, the feedstock for many fertiliser products. Thus we expect Potash Corp is well positioned to capture phosphate values

Potash Corp is one of the world's largest nitrogen companies with 7 plants in the US and a large complex in Trinidad which allows it to benefit from higher ammonia prices due to its low feedstock cost position.

Israel Chemicals (Buy)

We believe Israel Chemicals is well positioned to benefit in the coming years from rising potash and phosphates prices. In 3Q07, potash accounted for 30% of the company's sales and 57% of its EBIT. Phosphates accounted for additional 17% of sales and 20% of EBIT, bringing fertilizers to 47% and 78%, respectively. Other segments include industrial products (brominated flame retardants, oil drilling, etc.) and performance products (downstream phosphates used in the food industry and other).

ICL has potash capacity of 5.3 million tons KCl annually, of which 3.5 million tons are extracted from the Dead Sea and about 1 million tons each are mined from locations in the UK and Spain. In 2006, ICL was the sixth-largest producer of potash with 5.1mt; c10% of worldwide production. We estimate that ICL sells c.1.7 million ton a year to Europe, c. 1 million ton to India, c. 1 million ton to Brazil, c. 0.7 million ton to China and the rest to Israel and other markets. Accordingly, a large part of the company's sales is done in spot markets. The company's production in the Dead Sea (c.66% of the overall potash production) is a relatively low-cost production. In addition, the company's proximity to its target markets translate into lower freight costs. Another advantage is the dry climate in the southern part of Israel, which has allowed the company to accumulate excess inventory of over 1 million tons outdoors.

Qinghai Salt Lake Potash (Neutral)

Qinghai Salt Lake Potash Corporation (QSLP) is the largest potash producer in China, and it has more than a 60% share of China's domestic potash market. QSLP is a pure potash player and, given the tight supply, there is no price regulation on potash prices, which closely follow international prices. Therefore, QSLP enjoys a higher margin than other basic fertilizer producers.

■ **Statement of Risk**

The fertiliser market is strongly influenced both global and regional supply demand balances, as well as input and shipping costs. Unpredictable events in particular weather related ones can rapidly alter these balances and hence influence prices.

■ **Analyst Certification**

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	55%	39%
Neutral	Hold/Neutral	36%	36%
Sell	Sell	8%	20%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	25%
Sell	Sell	less than 1%	50%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2007.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

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Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Sell: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE) : Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Agrium Inc. ^{2c, 4b, 5, 16}	AGU.N	Buy	N/A	US\$62.80	30 Jan 2008
Israel Chemicals Limited ^{2b, 4a, 20}	ICL.TA	Buy (CBE)	N/A	NIS47.50	30 Jan 2008
Potash Corporation of Saskatchewan Inc. ^{2a, 4c, 16}	POT.N	Buy	N/A	US\$136.25	30 Jan 2008
Qinghai Salt Lake Potash ¹³	000792.SZ	Neutral	N/A	Rmb90.00	31 Jan 2008
Uralkali ^{2a, 4a, 16}	URKA.RTS	Buy	N/A	US\$7.38	30 Jan 2008

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

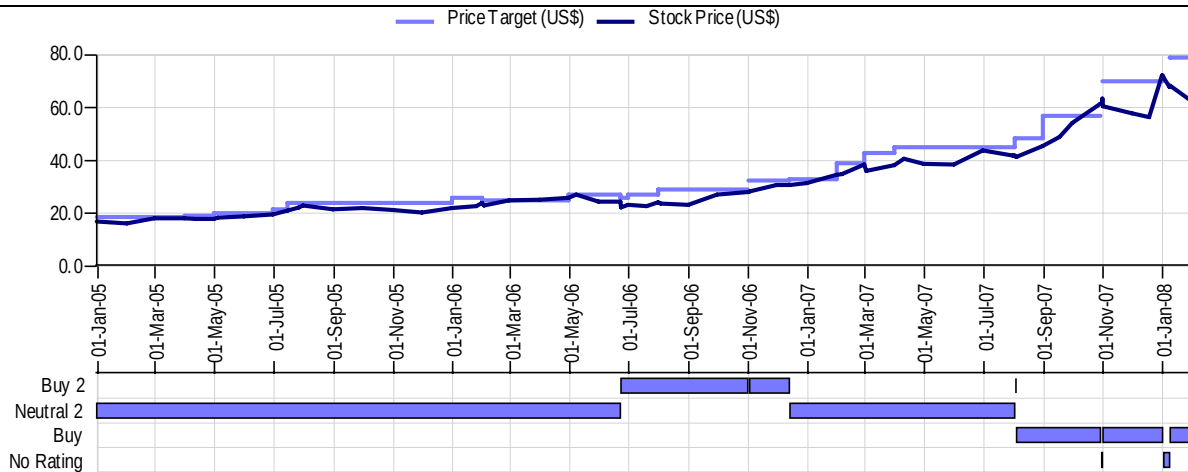
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- 2c. UBS Securities Canada Inc or an affiliate has acted as manager/co-manager, underwriter or placement agent in regard to an offering of securities for this company/entity or one of its affiliates within the past 12 months.
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20. Because UBS believes this security presents significantly higher-than-normal risk, its rating is deemed Buy if the FSR exceeds the MRA by 10% (compared with 6% under the normal rating system).

Roni Biron assisted in the preparation of this research piece

The analyst responsible for this report has not reviewed the material operations of the issuer.

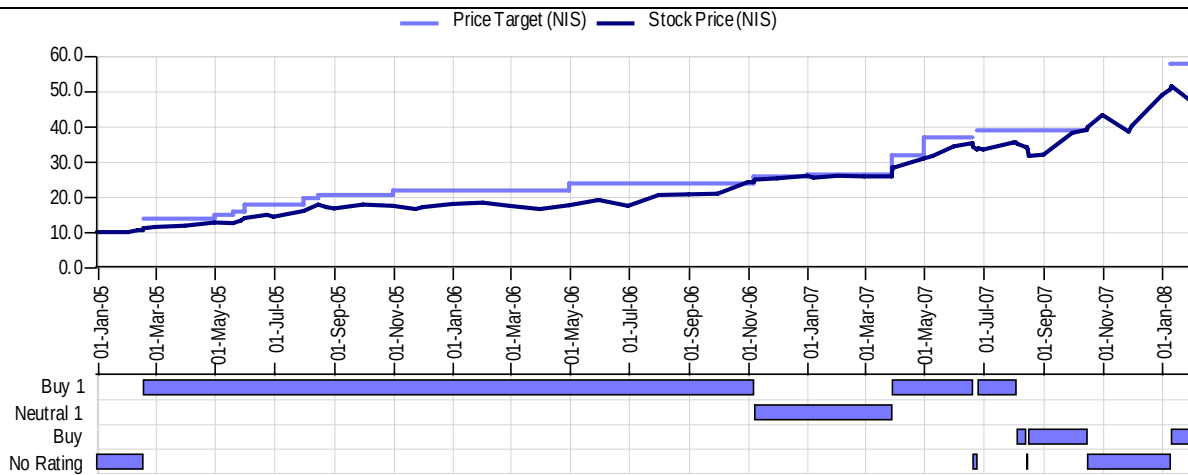
Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Agrium Inc. (US\$)



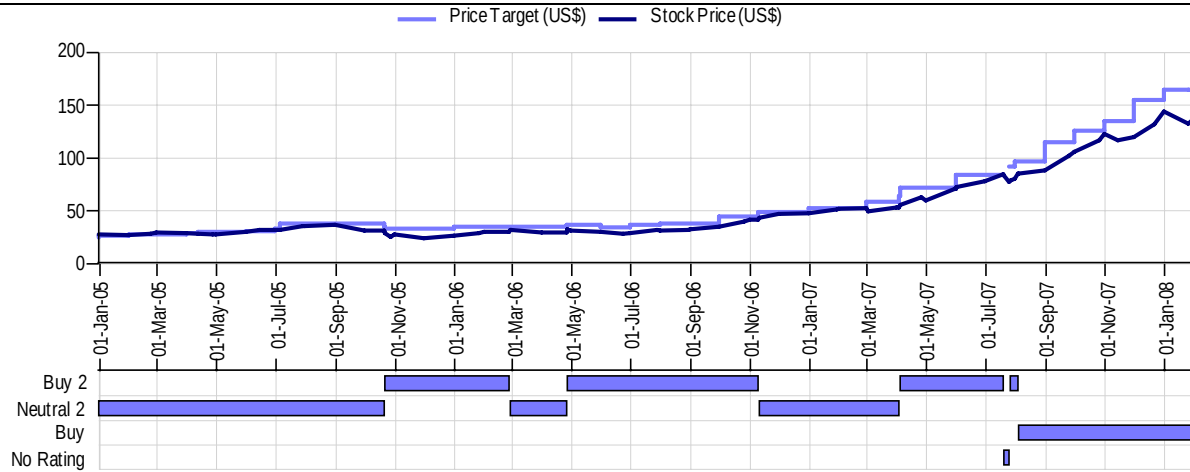
Source: UBS; as of 30 Jan 2008

Israel Chemicals Limited (NIS)



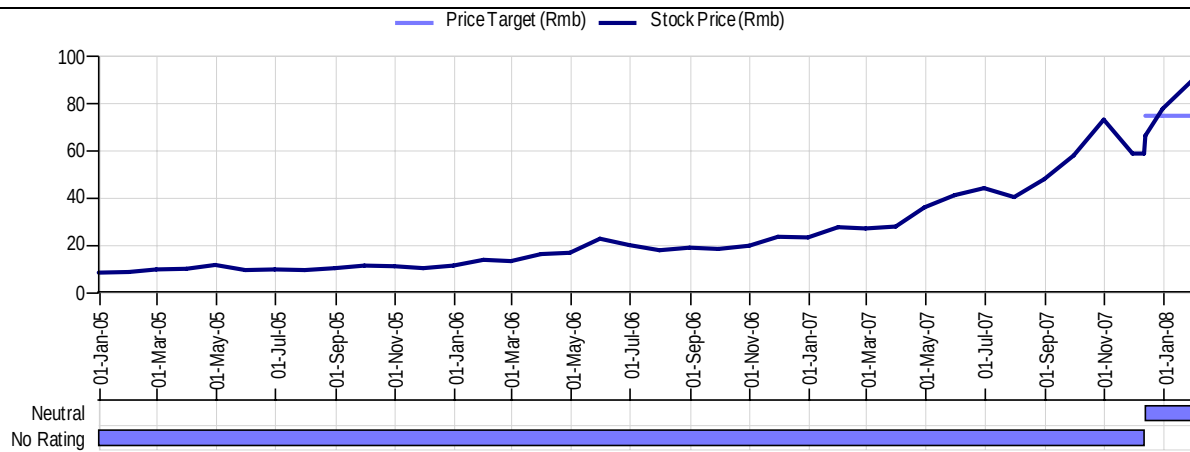
Source: UBS; as of 30 Jan 2008

Potash Corporation of Saskatchewan Inc. (US\$)



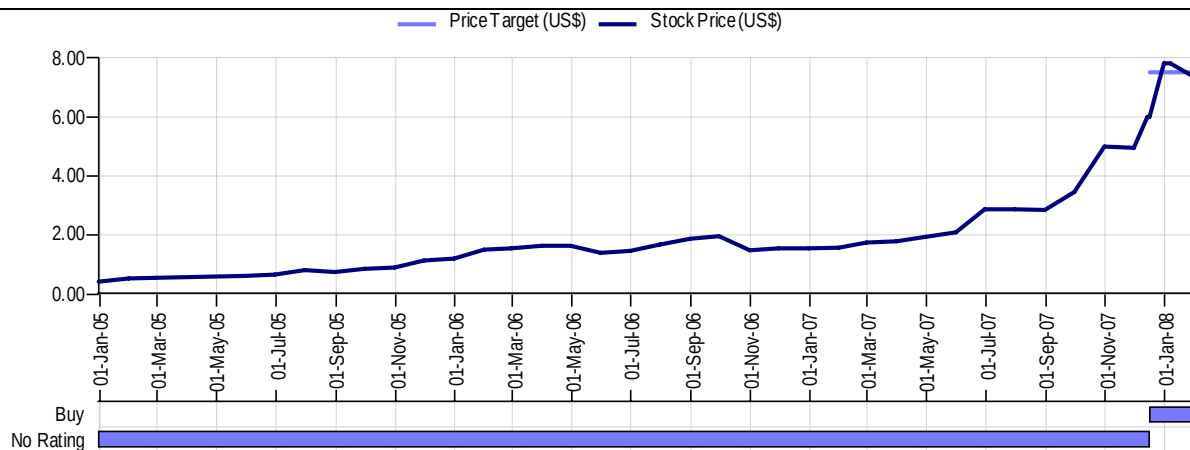
Source: UBS; as of 30 Jan 2008

Qinghai Salt Lake Potash (Rmb)



Source: UBS; as of 31 Jan 2008

Uralkali (US\$)



Source: UBS; as of 30 Jan 2008

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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